SACRAMENTO RETAIL PROPERTY INVESTMENT REACHES NEW HEIGHTS

Expansion of the Sacramento economy will continue to support its retail sector, and strong fundamentals for retail properties. The market also benefits from a large pool of investors from the San Francisco Bay Area that are seeking higher-income properties. These trends have driven investment activity and pricing to high levels, and growth is expected to continue through 2006, albeit at a more sustainable pace.

Downtown Residential Development Draws in Retail

Downtown Sacramento, which has had little residential life since the early 20th century, is in the early stages of a boom in high-rise residential development. By the end of 2006, nearly 700 units will have been completed, with approximately 2,000 more under construction. Overall, more than 3,400 units are in various stages of planning or construction in 20 projects. Most of these are in the Capitol Mall area; developers are also looking into building residential projects in the R Street area. This surge in residential development will spur growth of downtown retail, as all of these projects will include ground-floor retail space, adding up to 150,000 square feet of new high-end retail in the downtown area. Long-term prospects for downtown retail look even brighter, as the area develops a 24-hour lifestyle and attracts more retailers. The first initiative likely to move forward is the K Street project, which would revitalize two blocks of historic buildings and bring in up to 86,000 square feet of retail. Two developers have submitted competing proposals for the area.

Booming Elk Grove to Gain Mega-Mall

Recently incorporated Elk Grove, one of Sacramento's fastest-growing suburbs, will soon gain its own regional center in a huge mixed-use project. The Lent Ranch Mall is set to break ground in early 2006 on 105 acres at the junction of Highway 99 and Kammerer Road south of the city. The enclosed two-level mall will feature five anchors and a total of 1.3 million square feet of shops. On an adjoining 165 acres, another 1.8 million square feet will be developed, which will include more retailers, entertainment venues, office space and a 280-unit apartment complex.

Economy

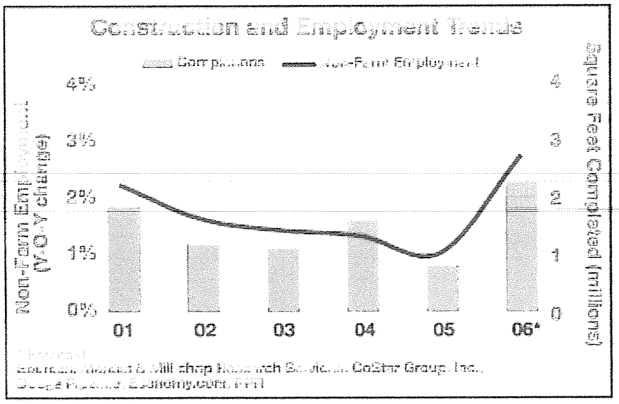
Sacramento economic growth is expected to pick up in 2006, creating 23,100 jobs over the year, a 2.7 percent gain after a 1 percent increase in 2005. The MSA continues to benefit from its proximity to the higher-cost Bay Area, with many companies relocating to Sacramento and families moving to the area for the cheaper cost of living. This will fuel broad-based expansion, driving job creation in the professional and business services sector, the educational and health services sector, and the trade, transportation and utilities sector. In addition, the tourism and governmental sectors are projected to post strong growth. The robust economy will drive median household income up 5.1 percent, which along with continuing healthy population gains will fuel strong demand of the consumer sector, with retail sales projected to grow 8.2 percent in 2006, up from the 5.5 percent increase of last year.

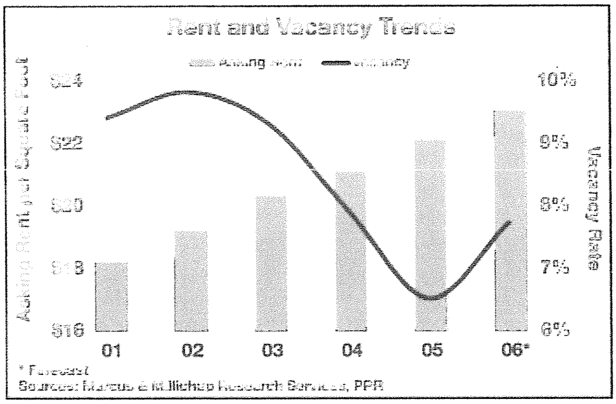
Construction

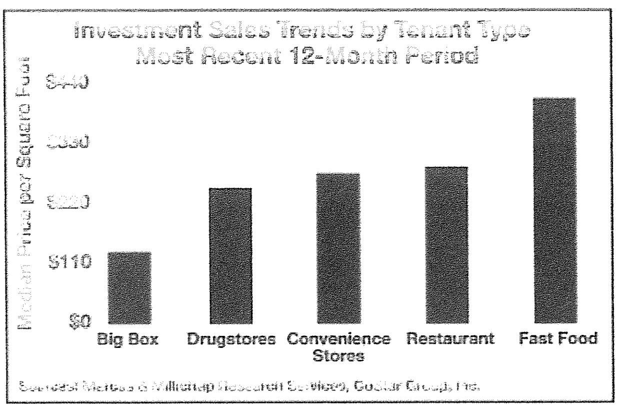
Completion of new retail space, which has lagged absorption for the past four years, is expected to jump to 2.3 million square feet after only 800,000 square feet was delivered last year. Most of this space will be in multi-tenant neighborhood centers with one large regional center, the 660,000-square foot Promenade at Natomas, being built north of downtown Sacramento near the river. Construction of a number of smaller centers, of 100,000 square feet or less, is distributed throughout the MSA. Nearly 400,000 square feet of these projects will be added in the northern reaches of the metro area in the vicinity of Lincoln, Rocklin and Roseville, with another 300,000-plus square feet added in the Citrus Heights, Folsom and Carmichael areas. Retail development is also ramping up in the rapidly growing Elk Grove area south of the city; however that area's largest project, the Lent Ranch Mall, will not come online until 2007. Over 200,000 square feet of retail will be completed in mixed-use projects, much of which will be in downtown Sacramento, as ground-floor retail in high-rise buildings.

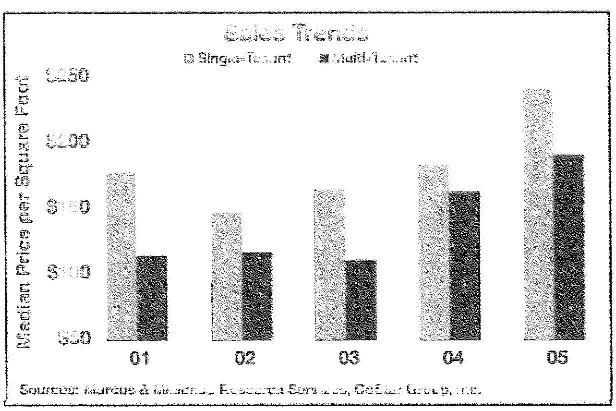
Vacancy and Rents

The surge in completions in 2006 will lead to a temporary 120 basis point rise in vacancy to 7.7 percent, after three successive years in which absorption outpaced deliveries and drove vacancy steadily downward. Shopping center vacancy will move up slightly, by 20 basis points to 4.6 percent. Elk Grove vacancy is expected to fall by 60 basis points by the end of 2006, to under 3 percent as absorption outpaces construction. Citrus Heights/Orangevale, the largest retail submarket, will post the highest rise in vacancy, by 120 basis points to 6.5 percent, as new centers coming online draw tenants away from older properties. Newer areas in the north of the submarket around Roseville and Rocklin, however, will continue to achieve low vacancy. Metrowide, asking rents will increase at a rate of 4.1 percent to an average of $22.85 per square foot, as tenants flock to newer and more expensive centers. Effective rents will









track the hike in asking rents, gaining 4 percent to an average of $20.59 per square foot. Elk Grove will remain the most expensive submarket with a 3.9 percent hike driving average asking rents up to over $33 per square foot. Rents in other submarkets are projected to reach a range of $19 per square foot to $23.50 per square foot by year end, after annual growth in all submarkets in a range of 3.5 percent to 4.5 percent.

Single-Tenant Net-Lease Sector

Demand for single-tenant properties is expected to remain strong in 2006 after healthy gains last year. Dollar volume in all types of single-tenant assets over the past year is up 9 percent, while the median price gained 32 percent to $242 per square foot. The average cap rate fell nearly 100 basis points to 6.25 percent and is expected to stay in this range through 2006. At this level, cap rates do not appear to vary substan-tially across areas or product. The median price for nationally branded fast-food outlets gained over 40 percent to $415 per square foot, while restaurants increased 18 percent to $289 per square foot. A wide variety of freestanding retail buildings sold at a median price of $242 per square foot, up 33 percent from the previous year. Activity was robust in all submarkets. Private investors from the Bay Area with funds from 1031 exchanges account for much of the buying activity. These investors seek to lock in gains on assets held in higher-priced markets, exchanging them for the relatively higher incomes available in Sacramento; single-tenant netlease investments are the lowest-risk option for such transactions. Sellers, however, have a hard time finding replacement properties and often go out of California to complete their exchanges and secure more favorable cap rates.

Sales Trends

Investment in multi-tenant properties is up substantially with dollar volume gaining 37 percent over the past year, while the median price gained 17 percent, to $191 per square foot. Prices are expected to appreciate at a more measured pace in 2006, in line with property incomes. Large deals for neighborhood and regional centers accounted for two-thirds of total dollar volume, but the largest number of deals was for strip centers under $5 million. Strong demand drove the median price for strip centers up 26 percent to $222 per square foot, well ahead of the $145 per square foot median price for neighborhood and regional centers. The overall average cap rate fell 50 basis points to 6.6 percent with newer product selling at a 6.25 percent to 6.5 percent cap rate. Investment is strong in all submarkets with availability of properties the most important factor. A number of deals for strip centers were closed in the South Sacramento area at a relatively cheap $158 per square foot. Investors paid much more for properties in rapidly growing suburbs, such as the Roseville and Rocklin areas where the median price reached $280 per square foot. While high land prices have many investor/developers looking for properties that can be redeveloped, value-add opportunities are becoming difficult to find with potential upside already priced in. Many owners, however, are redeveloping their own properties to take advantage of the strong retail market.

Summary

Fundamentals in the Sacramento retail market are robust, and the market's position near Bay Area investors ensures a high level of interest in retail properties. Cap rates have been driven to a low level throughout the market, while prices have risen dramatically; further price appreciation in 2006 is expected to be in line with continuing healthy income growth. Over the longer term, market performance will be underwritten by the strong economy, the large pool of investors in the area, and the constraints on new construction that will keep demand for existing properties high. **CC**